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SIPDIS

DEPT FOR US DEPT OF TREASURY DAVID WRIGHT

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SUBJECT: LATVIA: CENTRAL BANK GOVERNOR SEES CREDIBLE BUDGET  
AS KEY TO ECONOMIC FUTURE

REF: A. RIGA 508

[1](#)B. RIGA 494

[1](#)C. RIGA 484

[1](#)D. STOCKHOLM 632

[1](#)E. RIGA 401

[1](#)1. (C) Summary: The Bank of Latvia is downplaying the severity of new budget adjustments and the likelihood of significant mortgage relief, while admitting pressure on the lat could intensify unless a serious budget is submitted soon. The Bank is urging the early sale of Parex Bank. End Summary.

Budget

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[1](#)2. (C) The Governor of the Bank of Latvia, Ilmars Rimsevics, believes a credible 2010 budget is the key to Latvia's economic future. Rimsevics said the political parties are playing games with the country's credibility and hopes that the Cabinet's October 12 decision to adjust the budget by LVL 500 million (USD1 billion) is not merely a trick to preempt the October 13 visit of EC Economic and Monetary Affairs Commissioner Joaquin Almunia. Meeting with Ambassador Garber, Rimsevics downplayed the severity of the budget cuts as merely a return to early 2007 spending levels, noting that the government has yet to undertake serious structural reforms. Rimsevics predicted that pressure on the lat will intensify quickly if the government fails to submit a budget by its self-imposed October 28 deadline. He said it should be clear by next week whether the budget proposal is credible once details of the newly announced targets of LVL 320 million (USD 640 million) in expenditure cuts and LVL 180 million (USD 360 million) in tax increases are made available.

Mortgage Proposal

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[1](#)3. (C) PM Dombrovskis' announcement last week of a mortgage assistance proposal intended to limit the liability of homeowners to current asset value brought a swift rebuke from the Swedish government, the European Commission, and the Bank of Latvia. Rimsevics said that this announcement was merely an instruction to the PM's staff to explore the options for mortgage assistance and that Dombrovskis would meet with the banking industry next week to discuss the proposal. Rimsevics noted that legislative proceedings would likely amend any initial proposal, and stated that any proposal would not be retroactive. He tried to downplay the announcement's importance, admitting that he had spent time in Istanbul last week trying to explain the PM's announcement.

Pressure on the Lat

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[1](#)4. (C) Uncertainty about the prospects for the 2010 budget, coupled with the mortgage assistance proposal, has renewed

speculation on the future of the country's currency peg. Rimsevics said the Bank is still fully committed to 2014 euro adoption and is prepared and able to defend the lat against speculators. However, he admitted that the Bank made several small interventions in the foreign exchange market over the past week and that further delay in the budget process would add pressure on the lat. He also pointed to a recent spike in inter-banking lending rates and noted the similarity to currency pressure in June when the 2009 Supplementary Budget was still under consideration.

Resumed Growth: Budget Adoption/Parex Bank Sale Are Keys  
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15. (SBU) Rimsevics said it is difficult to pinpoint the sector of the Latvian economy that will drive its recovery, but that improving access to credit and restoring stability to the Latvian investment climate are essential to a return to economic growth, which he believes is possible by the 3rd quarter of 2010 with a credible budget. Rimsevics said a quick sale of Parex Bank is key to the restoration of adequate private credit flows to Latvia. He said that concerns that Parex's losses would continue under government control has led the Bank of Latvia to conclude that all of the components of Parex should be sold simultaneously, even if it is broken up into parts through a restructuring plan. Rimsevics concluded that it is more important to get Parex off the government's books than to wait for a full recouping of its equity investment.

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